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The Trust-based Partnership Model

An alternative financial Instrument for NEETs

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The following Thinking Space Paper explores *The Trust-based Partnership Model* as an alternative financial instrument for NEETs who start and grow a sustainable business and require financial resources. The model is explained at the example of the German Microfinance Institute (DMI). Key elements, structures and success factors are described that ensure the application of common rules and the development of the overall structure for the benefit of all stakeholders. Finally, the Thinking Space looks at the transferability of the model into other settings.

A well-functioning NEET support scheme in an entrepreneurial context requires innovative ways of financing a business, because the traditional banking loan is generally not available to NEETs. Banks consider in particular the most vulnerable NEET target groups such as single mums or migrants as not "bankable" due to their lack of conventional collateral, a lacking positive financial track record or the necessary entrepreneurial skills. In order to help these NEETs to become independent from family support or welfare and make a living from their own enterprise activities, alternative financial instruments allowing access to finance for NEETs are required.

An alternative financial instrument: The Trust-based Partnership Model

In the early 2000s small businesses and start-ups faced limited access to finance in Germany. The less favourable labour market at the time and political initiatives promoting entrepreneurship encouraged a significant number of people to set up their own business to overcome unemployment. Banks failed to address the need for more efficient procedures and to ensure portfolio quality. Hence, a market gap occurred which was addressed by public development banks such as the KfW Bank through dedicated micro-finance products employing the so called *Hausbankprinzip* (house bank principle). Under the house bank principle, entrepreneurs had to apply for a loan with their house bank and the KfW provided a guarantee to secure the loan. As the house bank had to cover up to 20% of the first loss, the incentive provided by the KfW to banks was considered insufficient to cover operational costs and the default risks. Banks were not able to provide highly standardized procedures based on credit ratings and/or business plans to assess loan applications of start-ups and small businesses nor cost efficient monitoring of loans or provide non-financial services to overcome entrepreneurial challenges in a sustainable way.

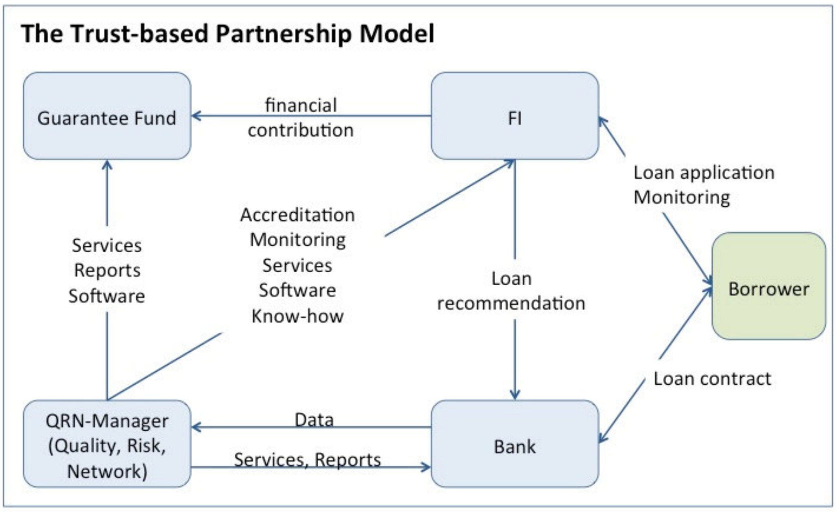
Against this background *The Trust-based Partnership Model* was developed by *Deutsches Mikrofinanz Institut (DMI),* a group of entrepreneurship support organisations, GLS bank and other relevant stakeholders. The model solves the problem of providing microcredits to target groups, which banks do not want to or cannot serve because this financial service is not profitable or sustainable. It also provides a solution to overcome the restriction of the national regulatory framework not allowing financial intermediaries or non-banking financial institutes (hereafter: FI) to disburse loans directly (banking monopoly). The *Trust-based Partnership Model* creates a self-sustainable system which generates revenues so that each partner can deliver services. The core design principle is cost-effectiveness which means that partners take over roles they can deliver more (cost-) efficient than others.

Key elements of the Trust-based Partnership Model are:

- It enables microcredit provision despite banking monopoly.
- It brings together a defined number of specialist stakeholders and service providers that support self-employed and business starters, and offers services that are complementary and synergetic.
- Each partner organisation brings in what it is best at and what it can easily deliver with its specific roles and responsibilities.

The partners assuming distributed services of the Trust-based Partnership Model are:

- Microfinance institutions (MFIs) assume the role of the operator, by acquiring the client and providing complete set of support services, including assessment of the loan application to the loan decision and to monitoring until the full repayment of the loan.
- The bank disburses the loans; however, as the entire loan handling process is the responsibility of the MFIs, the bank has no direct contact with the clients.
- A guarantee fund bundles all risk-sharing arrangements.
- A Quality Risk and Network Manager (QRN) assures the quality of service of partners and the whole system.



A central and essential element of *The Trust-based Partnership Model* is the QRN Managing Organisation. When it comes to establishing cooperation between banks and MFIs a neutral third party is often lacking which ensures the application of common rules and the development of the overall structure for the benefit of all. In Germany, the Quality and Risk Network Managing organisation was created by all involved actors who joined together in an association (DMI). The DMI took over all tasks necessary to sustain and develop the overall organisational setting. By doing so the involved actors jointly:

- Set transparent rules and document these in a common accreditation order
- Agree on common rules, coordinate and monitor common rules
- Accredit MFIs and ensure quality delivery of services
- Further develop the system (products, methods, procedures…), e.g. through taking part in regional, national or EU-projects and initiatives
- Consolidate data and reports
- Provide networking, training, advice and other services.

The DMI monitored that the microloans were handed out in a responsible way vis-à-vis the clients, funders and investors and that national and international quality standards were respected. These clearly defined tasks made it rather easy for interested parties to become an active stakeholder in microcredit provision.

Transferability of the Trust-based Partnership Model

To ensure a successful transferability of *The Trust-based Partnership Model* to other areas and legal frameworks, it is important that experienced actors are chosen. The know-how required to serves specific target groups cannot be found among just one actor/stakeholder. Therefore, know-how and experience needs be made available to all partners within *The Trust-based Partnership Model*. Best-practices, specialized know-how and tools need to be available and their application should be a mandatory part of an accreditation process to ensure a high standard of services provided by all partners. The following briefly describes the procedure in Germany to choose experienced partners, create best-practices and a trustful environment among all partners:

The DMI provided the basic know-how and tools to ensure quality of services as well as low default risks. The required know-how was compiled through transnational study visits, exchange of best practice as well as participating in national and trans-national projects. Learning's later found entry into the accreditation process and were disseminated through formal and informal trainings and exchange.

Partners of the *Trust-based Partnership Model* came from diverse backgrounds, e.g. public and private start-up centres, business consultants, tax advisers, philanthropic organisations involved in alternative currencies as a mean to foster economic development in rural areas etc. This wealth of know-how was used to improve the quality of services provided by all partners. Trainings and coaching were delivered by partners for partners of the Partnership Model and thus increased the acceptance and implementation of learning.

In addition to existing know-how, new approaches and tools were identified and tested among different target groups: e.g. lean start-up methodology, principles of effectuation, Self-Funding-Communities (CAF), alternative forms of collateral (asymmetric forms), different forms of risk assessment, attracting additional sources of funding, engaging the volunteer sector to safeguard loans and improve personal and entrepreneurial capacity, etc. The gathered experience and know-how should be made available to all partners through online and off-line trainings.

The success of the Trust-based Partnership Model depends on the partner's willingness to interact and create an environment of trust and mutual learning to adapt swiftly to challenges affecting the system (fraud-prevention, establishing more efficient procedures etc.), which could be the greatest strength of the overall system. The greatest weakness, the dependency on a single partner, be it the bank or the guarantee fund or any other role, creates an unfavourable imbalance and threatens the success of the overall system.

Thus, a self-learning and self-regulatory system is pivotal for expanding the scope of existing structures and services. Encouraging learning and further development in a bottom-up approach enables and encourages all partners to engage at different levels of development and experience and contributes largely to the overall success.

The Trust-based Partnership Model could be used to provide a robust microfinance framework for NEETs and can be started on a local level in close cooperation with experienced local actors. This local microfinance programme can later be scaled up to other cities or regions.